

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554**

In the Matter of	)	
	)	
Verizon Petition for Emergency Declaratory	)	WC Docket No. 02-202
and Other Relief	)	
	)	

**OPPOSITION OF THE COMPETITIVE TELECOMMUNICATIONS ASSOCIATION**

**I. Introduction**

The Competitive Telecommunications Association (“CompTel”) hereby submits its comments on Verizon’s Petition for Emergency Declaratory and Other Relief (“Petition”). In its Petition, Verizon asks the Commission to modify its policies in several ways calculated to benefit Verizon, at the expense of consumers, competitive carriers, and other bankruptcy creditors. While it would certainly not be in the public interest for the Commission to grant the bulk of Verizon’s requests, it is not at all clear to CompTel that the present petition is the correct procedural vehicle for Verizon to obtain the relief requested. In its Petition, Verizon ostensibly asks the Commission to do four things “to protect” dominant carriers like Verizon from an uncertain economic climate. In effect, however, Verizon is asking the Commission to allow it to exercise its market power to restrict output in upstream input markets, raise its downstream rivals’ costs, and thereby elevate equilibrium price levels in downstream markets.

First, Verizon asks the Commission, on an *ex ante* basis, to “allow carriers to revise tariffs to ensure against nonpayment.”<sup>1</sup> Second, Verizon asks the Commission to assist it in its advocacy efforts in bankruptcy courts in order to secure the “adequate

assurance of payment” to which it believes it is entitled.<sup>2</sup> Third, Verizon asks the Commission to allow it to interrupt service to end-user customers of a CLEC’s successor in bankruptcy unless the purchaser of bankrupt CLEC assets agrees to pay Verizon the pre-petition debt of the bankrupt CLEC.<sup>3</sup> Finally, Verizon asks the Commission to modify its rules to improve the process of transferring lines between a bankrupt carrier and the carrier which acquires those lines. CompTel will offer comments on the first three of Verizon’s requests, all of which must be rejected outright as inappropriate for relief.

## **II. The FCC Cannot “Pre-Approve” Verizon’s Tariff Modifications Without Review, Regardless of Verizon’s Claimed Justification**

The Communications Act specifically requires that the charges of common carriers be just, reasonable, and not unreasonably discriminatory.<sup>4</sup> Further, the D.C. Circuit has stated that “[administrative] agencies should constantly be alert to determine whether their policies might conflict with other federal policies and whether such conflict can be minimized.”<sup>5</sup> In the present case, the tariff modifications for which Verizon seeks the Commission’s general pre-filing stamp of approval may, if granted, put the Commission in conflict with the competition laws and policies of the United States, as articulated by the U.S. Department of Justice and the Federal Trade Commission. Similarly, the FCC precedent cited by Verizon does not support the instant request for pre-approval of further tariff restrictions, but more appropriately argue for a reinstatement of rate of return regulation for Verizon.

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<sup>1</sup> Petition at 3.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.* at 8-10.

<sup>4</sup> 47 U.S.C. §§ 201(b) and 202(a).

<sup>5</sup> *La Rose v. Federal Communications Commission*, 494 F.2d 1145, 1146 (D.C. Cir. 1974).

**a. Tariff Modifications Which Allow A Dominant Carrier to Transfer Risk to the Creditors of Its Customers Are Inconsistent With Price Cap Regulation**

As an initial matter, Verizon seems fundamentally confused as to the relationship between risk and return in a competitive market. This confusion is exhibited not only in the logical and economic contradictions within this petition, but also in a letter to the Chairman proposing revisions to the Commission's TELRIC methodology filed only one week prior to the filing of this petition.<sup>6</sup>

For example, the Barr letter advocates in one paragraph that Verizon's wholesale prices should be based on a higher cost of capital to more accurately "reflect the competitive and regulatory risks an incumbent faces providing unbundled elements priced at TELRIC."<sup>7</sup> In the very next paragraph, the author argues that TELRIC prices must be adjusted upward to account for the increases in uncollectible revenues that will result from serving these riskier customers. The author explains, with no apparent irony, that if UNE prices are not increased to reflect a higher rate of uncollectible revenues, then "the carrier providing the unbundled element is left holding the bag."<sup>8</sup>

So, on the one hand, Verizon argues that capital costs must be raised to reflect greater "market risk," but, at the same time, prices must also be increased to eliminate this risk. Verizon repeats this flawed analysis in instant Petition, where Verizon asks the Commission to allow it to modify its tariffs "to ensure adequate assurance of payment by [its] customers," and in the very next paragraph explaining that "any meaningful resolution of the financial issues confronting the industry also ultimately requires

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<sup>6</sup> See, Letter of William P. Barr to the Honorable Michael Powell, dated July 16, 2002 and filed in CC Docket No. 01-338.

<sup>7</sup> Barr letter at 2.

<sup>8</sup> *Id.*

restoring prices to levels that reflect the true risk that carriers face in the market, and that allow recovery of the extraordinary costs that have been imposed on them as a result of the requirement to serve carriers with financial difficulties.”<sup>9</sup>

The irony here is, of course, that by insisting on regulatory elimination of risks as well as higher prices to compensate for those risks, Verizon seems to believe that it should be operating under a *downward-sloping* risk/return relationship. However, in competitive markets risk is positively correlated with expected return such that a risk-free rate of return would be expected to yield lower profits than a highly speculative enterprise would need to earn in order to satisfy its more risk-aggressive investors.

Nonetheless, it is not surprising that Verizon would come to its regulator for protection at the first indications that it may be suffering (for the first time) the effects of an economic downturn. The reason that Verizon’s plea for regulatory rescue is not at all surprising is that, as WorldCom recounts, the ILECs’ record earnings over the past five years were fueled in no small part by regulatory largesse.<sup>10</sup> It is, therefore, not surprising that Verizon would once again return to the secret of its success—the regulatory process. Unfortunately for Verizon, neither the present circumstances of the competitive industry, nor Commission precedent, can provide justification for the elimination of Verizon’s hard won “market risk.”

Indeed, the cases that Verizon cites to as support for the notion that its proposed tariff modifications will be “fully consistent with types of tariff revisions that the Commission has allowed local carriers to implement to reduce their risk of loss under

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<sup>9</sup> Petition, at 3.

<sup>10</sup> See, Comments of WorldCom, WC Docket No. 02-202.

circumstances similar to those facing the telecommunications industry today”<sup>11</sup> were all approved when ILECs were under rate-of-return regulation. When a carrier’s rate of return is capped and established at a baseline risk level, it only makes economic sense to allow carriers some means of eliminating risk, because they could not otherwise maintain their guaranteed rate-of-return in any other way, absent a price increase. With the instant petition, Verizon is *de facto* seeking yet another price increase despite the fact that it supposedly accepted higher risks in order to not have its earnings capped under rate-of-return regulation.

Indeed, the only way that “present circumstances” could possibly “demand similar tariff revisions”<sup>12</sup> would be if Verizon were willing to operate under a rate-of-return of 11.25%. While CompTel would not necessarily oppose a request by Verizon to once again be regulated as a rate-of-return carrier, what is clear is that Verizon must choose whether it wants to accept some risk in order to achieve returns over 11.25%, or whether it wants the Commission to eliminate its ordinary market risk. Regardless of the outcome, Verizon cannot have it both ways.

**b. Tariff Modifications Which Allow the Dominant Input Monopolist To Increase the Costs of Its Downstream Competitors Conflict With Antitrust Policy**

By allowing integrated dominant carriers to impose advance payments and security deposits that are calculated based on the most recent month’s bills, the Commission would be allowing dominant input suppliers to unilaterally raise the capital costs of their retail rivals in contravention of antitrust policy. Because competitive carriers typically have much higher capital costs than incumbent monopolies, any

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<sup>11</sup> Petition, p. 4.

<sup>12</sup> *Id.* at 5.

conscription of that capital by the ILEC (whether under the guise of “advance payments” or “security deposits”) will dramatically increase the effective (and per unit) costs of the competitive carrier’s remaining capital. Such an ability to increase the costs of its retail competitors is a strong tool with which to discipline “maverick” price setters.

Verizon itself provides a good example of how such tariff obligations would work to chill competition and facilitate cartel pricing. On August 5, 2002, Verizon introduced a new bundled service offering, which was covered in an article in the August 6<sup>th</sup> edition of *Telecommunications Reports* (“TR”). Here is some of the article:

But Verizon executives hinted, as they have before, that they would not seek to compete on price in offering consumer service bundles. The bundles being introduced today in Massachusetts and New York offer discounts: In upstate New York, for example, a subscriber would pay \$137.89 per month for a package of services that would cost \$197.67 if purchased separately. But similar savings are available from other service providers.

"This isn't about price," said Maura Breen, Verizon's senior vice president and chief marketing officer. "This is about being competitive in the marketplace and offering better value." She estimated that Verizon could gain \$500 million-\$1 billion in incremental revenue from the bundling strategy over the next five to six years.<sup>13</sup>

By “signaling” that it does not intend to compete on price, it is apparent that Verizon seeks to become the cartel “price leader” relative to its rivals such as AT&T and WorldCom, who are also offering bundled service offerings at prices similar to Verizon’s entry price. Verizon, as the dominant input supplier to its rivals is the natural price leader, because it can most easily detect and punish price-cutting “cheaters.”

The government competition authorities have noted, “[d]etection and punishment of deviations [from coordinated pricing] ensure that coordinating firms will find it more profitable to adhere to the terms of coordination than to pursue short-term profits from

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<sup>13</sup> “Verizon Goes Further With Bundling In Effort to Boost Sales, Retain Subscribers,” TR Daily, August 6,

deviating, given the costs of reprisal.”<sup>14</sup> Such an ability to detect and discipline departures from cartel pricing can enable the input monopolist to control, and increase, retail prices through what has been termed “exclusionary market power” or market power derived from the ability to raise rivals’ costs.<sup>15</sup> Such conduct imposes clear and certain costs on consumers as well as consumer welfare.

This exclusionary conduct harms consumers through higher downstream prices. Efficiency also can be reduced in two ways from this conduct. First, the consumer deadweight loss involves an efficiency loss as consumers reduce their purchases. Second, the higher cost borne by rivals may lead those firms to utilize an inefficient mix and the market shares of relatively more efficient firms may also be reduced.<sup>16</sup>

Punishing cartel “cheaters” would be especially easy for Verizon if the Commission were to adopt a policy that the tariff modifications requested were acceptable, because any retail price “cheater” will quickly become known to Verizon, due to its increased input consumption. By pre-approving tariff modifications that allow vertically-integrated dominant input suppliers like Verizon to automatically discipline competitive carriers by increasing their capital costs in direct proportion to their increased input (switched and special access) purchases, the Commission’s policy would be placed in direct conflict with U.S. competition policy. Any tariff language which grants the incumbent discretion to impose costs on its retail rivals can be expected to have a similar chilling effect on competition and consumer welfare.

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<sup>14</sup> *Horizontal Merger Guidelines of the United States Department of Justice and the Federal Trade Commission*, Issued: April 2, 1992, Revised: April 7, 1997 at Section 5.1 (footnote omitted) [“Guidelines”].

<sup>15</sup> See, *Riordan and Salop, Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 *Antitrust L.J.* 513, 527 n. 39.

<sup>16</sup> *Id.* at 527.

### **III. The Commission Should Refuse Verizon's Request To Support Its Advocacy Efforts In Bankruptcy Proceedings**

Verizon's request that the FCC "inform" bankruptcy courts that dominant carriers are entitled to greater assurance of payment than other creditors is nothing so much as an invitation for the FCC to formally adopt a guiding policy that "what is good for Verizon is good for America." Such a suggestion is patently contrary to the Commission's mission on behalf of U.S. telecommunications consumers, and should therefore simply be rejected out of hand.

### **IV. The FCC Should Not Interfere With the Transfer of Assets In A Bankruptcy**

Verizon asserts that when a carrier purchases the assets of a bankrupt carrier, the new purchaser can assume the bankrupt carrier's pre-existing contract (pursuant to either contract or tariff), in which case the new carrier must cure prior indebtedness. Verizon's description of its contract rights vis-à-vis a new purchaser is either accurate, or not. In either case, any failure by Verizon to get the relief it expects under the Bankruptcy Code must be addressed in a forum other than the FCC. The Supreme Court has clearly held that "[w]e do not read the Communications Act to give authority [to the Commission] to determine the validity of contracts between licensees and others."<sup>17</sup>

Therefore, of the three possible situations Verizon describes that will apply to a new purchaser of a bankrupt carrier's assets, the third is the only one which is the proper concern of the Commission. This situation is one in which the new purchaser chooses to reject the existing contract of the bankrupt carrier, which it is free to do. In this situation, Verizon requests that the Commission allow it to disconnect the lines purchased by the new carrier in order to initiate service under either a new agreement with Verizon, or

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<sup>17</sup> *Regents of the University System of Georgia v. Carroll, et al.*, 338 U.S. 586, 602 (1950).

pursuant to a tariff on file with the Commission. Verizon would have the Commission believe that this position is both in the public interest and necessary to preserve the integrity of the bankruptcy process.<sup>18</sup>

While it is hard to speculate as to whether Verizon's position would be meritorious, or merely meretricious, under any specific set of facts—what is beyond dispute is that the FCC cannot adopt Verizon's policy positions in a petition for declaratory relief. Declaratory relief is available to terminate a controversy or to remove uncertainty when the facts are clearly developed and essentially undisputed, and the governing law is clear.<sup>19</sup> None of those situations is presented in the present petition.

Notwithstanding Verizon's present failure to present a controversy which could be terminated by a declaratory ruling, there are considerations beyond those raised by Verizon that the Commission should consider should this issue present itself in a justiciable context. The Commission should be extremely wary of allowing an ILEC to disconnect end-users as a condition to the new buyer in bankruptcy rejecting an executory contract, and initiating a "new" service arrangement with the ILEC. The ILEC stands in a unique situation to other creditors, even other carrier creditors, because, as we have noted, the ILEC is both a critical input supplier of the new purchaser as well as a dominant retail competitor of the new carrier.

Therefore, the incumbent LEC is unique as a creditor in that it enjoys maximum benefit, not from a "cure," but by having the competitive assets exit the market. Because of the ILEC's monopoly market shares in both the upstream (input—switched and special access) and retail markets, the ILEC can predict with relative certainty that its retail arm

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<sup>18</sup> Petition at 10.

<sup>19</sup> *American Network Inc.*, 4 FCC Rcd 550, 551 at ¶ 18 (CCB 1989).

should be able to capture a dominant share of any wholesale lines lost as a result of the complete exit of those competitive assets. Because of its unique incentives, the ILEC creditor's interests may well diverge from the policy goals of the bankruptcy laws, the antitrust laws, and the communications laws.

In order to appreciate all of the potential policy considerations, the Commission should first be mindful that in any situation like the one described, a “new” carrier has purchased not only the assets of the bankrupt carrier (which, by the terms of Verizon’s hypothetical, were the subject of a pre-existing executory contract with the incumbent LEC), but also the end-user customer contracts. Many of these customer contracts may well have “service level agreements” (“SLAs”) which guaranty a level of network reliability, and provide severe penalties for network outages which exceed the agreed-upon levels. Because the most valuable, telecommunications-intensive end-users will almost always require such performance guarantees, allowing the ILEC to disconnect and then re-connect customer lines provides the ILEC with a powerful tool with which to erect entry barriers to new competitive carriers operating the assets of a bankrupt carrier. The Commission would thus be allowing the ILEC to raise the costs of prospective entrants by either insisting on a cure of prior indebtedness (which, because of the ILEC’s perverse incentives, may be quite large) or imposing costs on the new entrant in the form of SLA penalties, and the dissipation of the value of the newly-acquired customers through accelerated customer attrition.

While the anticompetitive consequences of the Commission adopting a policy such as that counseled by Verizon are apparent, what may not be so readily apparent is how this policy would conflict with other federal policies in contravention of established

law.<sup>20</sup> As an initial matter, if incumbent LECs are able to insist on “predatory” cure amounts, relative to those received by other creditors, under threat of end-user service interruption, the Commission may well exacerbate losses for other creditors, over time further restricting capital available to this industry. While Verizon, from its uniquely dystopic perspective, sees this consequence as a virtue<sup>21</sup> it is doubtful that Chairman Powell, who has identified the significant capital shortage facing the industry as a significant barrier to the industry’s economic recovery, would concur.<sup>22</sup> Thus, adopting the policies Verizon articulates are contrary to the goals of not only the Commission, but the policies underlying the bankruptcy laws. Indeed, CompTel is aware of no portion of the Bankruptcy Code which professes to support the inequitable treatment of creditors and purchasers in favor of one creditor with unique incentives to frustrate the efficient transfer of estate assets and the equitable distribution of the proceeds of the sale of these assets among all creditors.

Similarly, if the Commission were to adopt a policy giving the ILEC permissive discretion to disconnect existing service arrangements, unless the purchaser in bankruptcy agrees to pay in order to keep the lines connected, the Commission’s policy would also frustrate the clearly articulated policies of the U.S. competition authorities. In the DOJ/FTC Horizontal Merger Guidelines, one of the predicates to establishing what is known as the “failing firm” defense to an anticompetitive merger which would otherwise violate Section 7 of the Clayton Act<sup>23</sup> is that the firm to be acquired by the anticompetitive purchaser “has made unsuccessful good-faith efforts to elicit reasonable

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<sup>20</sup> See, e.g., *LaRose* at 1146.

<sup>21</sup> “In effect, the proceeds of the sale are reallocated, with more going to the underlying carriers and less to other creditors such as the debtor’s bank lenders.” Petition at 10.

<sup>22</sup> See *generally*, Remarks of Chairman Michael Powell before the Senate Committee on Commerce,

alternative offers of acquisition of the assets of the failing firm that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.”<sup>24</sup> The Guidelines generally define a “reasonable offer” as any price (*i.e.*, \$1) over the liquidation value of those assets.<sup>25</sup> Thus, a policy that allows an ILEC to, in a permissive and discretionary manner, impose non-price costs on an acquirer of bankruptcy assets would render the acquisition of those assets by a competitive purchaser an impossibility; thereby improperly clearing the way for absorption of these assets by the incumbent monopolist.

### **Conclusion**

For the foregoing reasons the Commission should deny Verizon’s Petition for Emergency Declaratory and Other Relief.

Respectfully submitted,

\_\_\_\_\_/s/\_\_\_\_\_  
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<sup>23</sup> 15 U.S.C. § 18.

<sup>24</sup> Guidelines at Section 5.1 (*footnote omitted*).

<sup>25</sup> *Id.* n. 39.